FOMC BRIEFING
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July 9, 1980

Against the background of the chart show, I would like to review a number of considerations that may affect the Committee's choice of longer-run monetary targets.

As explained in the Bluebook, we believe that the marked shortfall in M-1A growth in the second quarter relative to our models' predictions will not persist over the balance of the year--and that there will, in fact, be some minor effort by the public to rebuild excessively depleted cash balances. Thus, despite no more than about a 5 percent annual rate of nominal GNP growth projected for the second half of this year, we would anticipate demand for narrow money to grow at a rather faster rate. This assumed behavior of money demand would make it plausible for the Committee, if it wished, to retain its present 3-1/2 to 6 percent range for M-1A for 1980. For example, growth in M-1A at a 7 to 8 percent annual rate over the second half of the year would be sufficient to bring growth for the year 1980 into the lower half of the present longer-run range and might be accomplished without extremely large further changes of interest rates.

There are two risks to such a course. On the one side there is an inflationary risk. We have assumed, as I noted, that the public will not continue to shift away from cash over the balance of the year as it did in the second quarter--indeed, that the public will try to make up a bit of the recent cash shortfall. Should the public continue, however, to shift away from cash--somewhat as they did from 1974 through mid-1977--attempts to supply enough M-1 to move that aggregate into its longer-term range would lead to a very substantial lowering of short-term market interest rates from present levels, probably a negative real rate of interest over the balance of the year in short-term and possibly also long-term markets, and evidence of inflationary growth of the aggregates becoming more evident in the behavior of M-2.

I would not want to exaggerage the inflationary risk of an effort to move M-1 back up into its longer-term range. The odds on a further significant shift away from cash over the balance of this year seem reasonably small. The so-called shift in the second quarter represented the largest quarterly shortfall since our experience with shortfalls beginning with the mid-'70's. And on that ground alone, we may be dealing in good part with an aberration, at least in magnitude.

Which leads to the second risk--the deflationary one. If the second quarter was in part aberration and the public should wish to reconstitute depleted cash balances at a more accelerated pace than assumed, efforts to constrain growth to the assumed pace would raise interest rates in the short run by even more than we have projected and exert further downward pressure on nominal GNP.

A balancing of the risks might suggest that the range for narrow money in 1980 should be left unchanged, or, perhaps, reduced a bit. But decisions about 1980 also need to take account of the prospects for 1981. Last year at this time the Committee indicated that it expected growth in the year ahead--which was then 1980 of course--to be within the ranges adopted for the current year, and then added a caveat about emerging economic conditions and changing deposit mix from legislative developments. This year, I would assume that the Committee would wish to consider a similar approach, or possibly suggest that it might seek lower growth next year, without being very specific.

Either of these two approaches raises a problem, though, and the problem would be compounded if the 1980 range for the narrow aggregates were lowered. The problem relates to the fairly large almost 11-1/2 percent rise in nominal GNP that is currently projected for 1981, given the tax cut that we have assumed. If the Committee wished to <u>seek</u> such a rise in nominal GNP, and if narrow money growth were kept at around the midpoint of the present range, it would require as noted in the Bluebook, a rise in the income velocity of narrow money at a rate that has not been seen for a calendar year since 1955 or on a 4-quarter basis, since the first four quarters of the 1975 recovery. Our model would suggest that, even given the rise of interest rates we have projected, narrow money growth should be about 3 percentage points higher, and growth of income velocity correspondingly lower, to finance an 11-1/2 percent GNP growth. Of course, the model is not to be taken literally, and it may well be underestimating the degree to which the public wants to economize on cash at the presumed high level of interest rates, given the increased and increasing sophistication of savers and the ready availability of money substitutes. Still there remains the non-trivial chance that even the upper end of the present longer-run ranges for M-1A or M-1B would not be sufficient to finance GNP growth in the 11-1/2 percent area next year.

There may not be so much of a problem for M-2, though. The projected growth of income velocity of M-2 in 1981 is more within the admittedly wide range of its historical experience. Apart from that, measured M-2 next year will not be affected by introduction of nationwide NOW accounts, as will measured M-1A and M-1B. However, even with this aggregate, there seems to be little, if any, scope for reducing the range next year. We would project growth in both M-2 and M-3 to be near the upper limits of their present ranges in 1981 as recovery of income generates more saving and increased credit demands cause banks and thrift institutions to bid actively for those funds. Thus, it may be difficult to achieve a reduction in money growth rates even if the Committee shifted its emphasis from M-1A or M-1B to M-2.

In sum, it would appear that the most promising practical choices before the Committee are:

- -- with respect to the money supply ranges for 1980, either (a) leave them unchanged, though perhaps indicating that the narrow money measures may be in the lower part of the ranges, or (b) lower the ranges for M-1A and possibly also M-1B, perhaps only the bottom ends of the ranges, to suggest the possibility that the Committee would not seek very sharp acceleration of money growth over the balance of this year. If the top of the range were lowered to avoid a widening of the range, or to achieve a narrowing, this would increase the risk that growth in 1981 might be above the upper limit of the 1980 range.
- -- with respect to the money supply ranges for 1981, either (a) indicate that growth would be expected to be within the ranges established for 1980, or (b) suggest that further

progress in lowering growth is expected, without being specific as to growth rates or growth ranges at this point, while noting that the degree of progress depends on economic circumstances and that in any event interpretations of the aggregates will be affected by the impact of introduction of nationwide NOW accounts and further development of such newer investment outlets as money market funds.

-- with respect to bank credit, that would appear to be the clearest candidate for some range reduction in 1980; a reduction to a 5 to 8 percent range might mean that the range would not need to be raised in 1981 as credit demands increase in line with economic recovery.